

Private Letter Ruling: Private Letter Ruling IT 92-0145 partially revoked. Income from covenant not to compete is business income unless clearly classifiable as nonbusiness income.

July 12, 1999

Dear:

Please find enclosed for your reference a copy of a private letter ruling (number IT92-145), dated May 11, 1992, which was sent to your office on behalf of xxxxxxxxxxxxxx (SSN xxxxxxxxxxxxxx) and xxxxxxxxxxxxxx (SSN xxxxxxxxxxxxxx). On pages 3 and 4, that letter states:

We conclude that the income received under the covenant not to compete does not constitute business income as defined in Section 1501(a)(1) of the Illinois Income Tax Act inasmuch as the income does not arise in the regular course of a taxpayer's trade or business. Rather, the income arises from the liquidation of the taxpayer's interest in the business. The sale of the partnership interest in the automobile dealership gives rise to this non-business income. Payments received under a covenant not to compete are treated as ordinary income for federal income tax purposes (Rev. Ruling 69-643, 1969-2 CB 10). Therefore, this income will be allocated pursuant to either Sections 301 or 303 of the Act depending upon the resolution of the factual issue of residence of the taxpayers.

In *Texaco-Cities Service Pipeline Company v. McGaw*, 182 Ill. 2d. 262 (1998), the Illinois Supreme Court rejected the taxpayer's argument that a transaction must occur in the "regular course" of its business in order to produce business income. The Supreme Court also declined to hold that gain realized upon a sale made in liquidation of a taxpayer's business was non-business income as a matter of law. To the contrary, the Supreme Court held that a sale of nearly 90% of the business of the taxpayer in that case generated business income.

86 Ill. Admin. Code § 100.3010(a) provides that all income "is business income unless clearly classifiable as nonbusiness income." Because the ruling request did not state any facts with regard to the transaction except that it involved the sale of a partnership interest, there was no basis for ruling that the income from the covenant not to compete was nonbusiness income. Accordingly, the portion of the private letter ruling stating that the income was nonbusiness income is revoked. In the absence of any facts indicating the contrary, the income should have been characterized as business income.

Please note that Section 4(c) of the Taxpayers' Bill of Rights (20 ILCS 2520/4(c)) requires the Department:

To abate taxes and penalties assessed based upon erroneous written information or advice given by the Department.

Accordingly, to the extent characterizing the income from the covenant not to compete as business income would increase the Illinois income tax liability of the xxxxxxxx, or result in interest or penalties due, for any taxable year for which they have filed a return in reliance on the private letter ruling we issued to them, or to the extent such characterization would result in any penalty for underpayment of estimated tax in the current year, such taxes, interest or penalties must be abated. If, on the other hand, characterizing such income as business income would entitle the xxxxxxxx to a refund for any year for which the statute of limitations has not expired, they should file a claim for refund following the usual procedures.

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This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax